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SUBJECT: THAKSIN,S ECONOMIC POLICY: THE NEXT FOUR YEARS

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SENSITIVE BUT UNCLASSIFIED

1.(SBU) SUMMARY AND INTRODUCTION. The overwhelming victory achieved by Prime Minister Thaksin's Thai Rak Thai (TRT) party in the February 6, 2005 general elections, in which TRT won 376 of 500 parliamentary seats, offers Thaksin an unprecedented degree of political power for a democratically elected Thai politician. This cable is a first-take (before a new cabinet has been named) on what economic policies the new administration will pursue in the aftermath of TRT's electoral mandate. Our conclusions are:

- There will not be any policy surprises. Thaksin will follow the goals he laid out in his electoral platform.

- These goals are to undertake catch-up infrastructure "mega-projects" to stimulate domestic investment, continue raising rural incomes, encourage the development and expansion of SMEs, increase the competitiveness of Thai industry and Thailand's logistical ability to compete, and conclude regional and bilateral trade agreements to gain a market advantage for Thai producers and make Thailand a center of Asian trade; all while slowly reducing government debt.

¶2. (SBU) Thaksin, flush with victory and confident that his first term economic polices (which his critics described as overly populist) have been vindicated by Thailand's economic growth record, has the political power to push all these programs ahead. The questions are how he chooses to spend his political capital - since many of his programs will call for such unpopular actions as privatization of state-owned enterprises and other sorts of economic liberalization, including FTAs with the U.S. and others, - and whether his penchant for clever-but-complicated financial engineering to fund projects off the RTG books proves sustainable. It is an open question whether Thaksin, ever sensitive to criticism, will husband his political capital and not undertake needed economic liberalization if opposition proves too fierce or there is any significant slowing in the Thai economy. END SUMMARY AND INTRODUCTION.

¶3. (SBU) On February 7, immediately following TRT's historic sweep of 75 percent of parliamentary seats, the party released an outline of its economic goals for the next four years entitled "Towards economic transformation." It begins by identifying the previous four-year period as a time to "repair and revive" and sets a new goal of "transformation and restructuring of Thailand to meet the challenges of the increasingly competitive global arena." The document then lays out four sub-goals; 'assuring prosperity of the people; enhancing the production sector's competitiveness, building infrastructure to enable progress and from local links to global reach."

Trickle-Down Economics, Thai Style

¶4. (SBU) As has been reported (ref A), a key component of Thaksin's first administration was the stimulation of domestic demand to revive the economy following the 1997-1998 economic crisis. RTG programs designed to funnel cash into the hands of rural citizens combined with commercial bank's post-crisis focus on consumer credit which introduced credit cards and other consumer finance products to many Thais for the first time, led to a surge in demand for Thai-made motorbikes, cars and appliances (because of the weak baht and tariff barriers, imported goods at the lower-end of the market are not competitive with domestic producers). This recovery of domestic demand with a revival of export markets helped Thai manufacturers utilize the enormous capacity they had added in investment boom of the 1990s. The RTG focus on domestic demand, combined with continued efforts to increase exports, was the heart of Thaksin's first term economic approach - the so-called "dual-track strategy".

¶5. (SBU) Under the rubric "assuring the prosperity of the people", Thaksin has identified "strengthening the grass-roots economy" as a continued focus during his coming term. This is defined largely as programs to "empower local communities to better manage their own finances" together with "removing barriers" and "unlocking the great potentials that flow from(grassroots knowledge, creativity and skills." Most of our interlocutors argue that the economic development aspect of Thaksin's rural programs have actually done little but provide a quick boost to rural consumption and confidence. A program which provided each village a Bt1 million revolving loan to invest as they pleased, for example, was largely used to fund consumption rather than investment. Aggressive lending by special purpose government banks (the Government Savings Bank and Bank for Agriculture and Agricultural Cooperatives) also served largely to finance the many new one-ton pickup trucks and color TVs that are seen in the countryside. Consi
derable anecdotal evidence indicates that when these loans came due, the borrowers reverted to traditional village money lenders (who charge usurious rates) to pay off the official loans that were typically collateralized by houses and farmland. The RTG can be expected to continue to encourage programs to lend to rural sectors and keep the credit/consumption cycle flowing.

¶6. (SBU) These programs and such others as "One Village One Product" handicraft development plan are marketed by the RTG as empowerment and development programs. However, many observers believe they are actually more akin to an income redistribution policy. With 60 percent of all Thais still living in villages and no other government social safety net, these programs are both politically expedient and have been an effective way to "prime the pump" economically while calling it "rural empowerment" rather than rural welfare. Although these programs will continue over the next four years, they are not the centerpiece of the Thaksin economic strategy going forward. With pent-up consumer demand largely satisfied and consumer indebtedness at record heights, Thai economic policy is to look elsewhere for future economic drivers.

Enhancing Competitiveness Through FTAs

¶7. (SBU) In order to assure a continuing surplus available for redistribution, and to generate the growth in GDP that Thaksin views as the bottom-line measure of his success, the new Thaksin administration has said "the private sector needs to focus on restructuring to compete effectively in the globalized marketplace." What this restructuring and reform are supposed to look like is not identified, perhaps because it is widely accepted that Thai industry needs to end such practices as rent-seeking behavior, poor corporate governance and a failure to upgrade labor and management skills that are below those of Thailand's competitors - all problems attributable in large measure to long-standing protection from foreign competition for many industry sectors.

¶8. (SBU) Key RTG policy-makers have identified FTAs as a means to force the private sector to reform by removing trade barriers, thereby exposing Thai companies to global competition in their home market. Officially, Thaksin views FTAs as part of a "global reach" strategy designed to open doors to the "unique" qualities of Thai goods and services and place Thailand at the center of a web of bilateral and regional trade agreements. While these stated goals make sense, we believe the greatest benefits to a comprehensive FTA with a country like the US would be in the positive effects on the Thai economy from liberalization; a view espoused by at least one senior advisor to the Prime Minister. The political difficulty of carrying forward such liberalization, even under the cover of an FTA ("the Americans made us drop your protection"), was evidenced by the hiatus on bilateral FTA talks with the US in the run-up to the Thai elections - primarily out of concern that the FTA could be used by the opposition to bludgeon the government. We are not sure if Thaksin and his government will be able to muster and sustain the political will to successfully conclude comprehensive FTAs with Thailand's major trading partners. We are certain, however, that in the absence of such an external influence, real reform in the private sector will not occur - a view shared by most Thais.

¶9. (SBU) An indication of the seriousness with which Thaksin is taking his new economic agenda (and perhaps indicative of the difficulty he anticipates in its implementation) is the mooted elevation of Finance Minister Somkid to Deputy Prime Minister responsible for economic affairs. Somkid is the Prime Minister's key economic advisor and one purpose of giving him effective strategic control over all aspects of the Thai economy would be to ensure that implementing agencies carry out the administration's strategic vision and that necessary decisions are made quickly. This was related to Ambassador Boyce during a February 13 meeting with Thaksin at which it was suggested that Somkid would play an important

role in the FTA talks with the U.S. (ref B).

¶10. (SBU) Another difficult area we expect Somkid to manage is the privatization of state-owned enterprises (SOEs). During his first term, Thaksin failed in his attempt to sell shares in the government electricity company EGAT following strong opposition from the company's labor unions and NGO groups which argued that the exercise was simply a way for company management, TRT officials and other insiders to make a quick buck from the floating of shares - as they argue occurred in the partial privatization (corporatization) of Thai Airways and oil giant PTT. The government has pledged to again try to privatize EGAT (and perhaps some of the other 60-70 SOEs) through a process that begins with a relatively small (20 percent of total equity) floatation on the Bangkok stock exchange, leaving the RTG as majority owner. The Thaksin privatization goals are to eventually remove the government's contingent liabilities associated with SOEs, to encourage greater competition in the business sectors in which the SOEs operate and promote sound business practices in these companies.

¶11. (SBU) The emphasis Thaksin puts on markets is somewhat belied by the continuing subsides the RTG provides to consumers for diesel fuel and electricity prices. The diesel subsidy is expected to start phasing out as of March 2005 (although there is talk of waiting until May so that the economic impact of the tsunami dissipates first). There is no indication, however, that electricity prices will be unfrozen and the subsidy to make up the cost differential to EGAT will change. We believe that Thaksin and his advisors continue to wrestle with the issue of ensuring Thai businesses have low-cost basic inputs in order to be competitive with their regional competitors while realizing that such subsides distort company business decisions. We believe that during the second Thaksin term, subsidies will very slowly be phased out with the RTG stepping back in to prevent any price spikes.

Infrastructure

¶12. (SBU) The government has announced a series of "mega-projects", primarily to upgrade Thailand's transport infrastructure. The RTG estimates that its companies pay 20 percent more than regional competitors for logistics and transportation due to inefficient and antiquated infrastructure. It is true that since the late 1990s economic crisis, few new infrastructure projects have been started due to the need for fiscal rectitude and, as a result, Thailand needs to play catch-up with much of its infrastructure. We believe, however, that the government's primary purpose for the US$20-26 billion that it plans to spend on such projects is the need to create a new driver to Thailand's economic expansion - investment -to replace the now largely played-out consumer consumption driver.

¶13. (SBU) Some observers are concerned that the RTG will fund these projects through increased government spending and additional debt issuance. While there is little doubt that there will be some increased government spending and new RTG-backed debt associated with these projects, we believe that Thaksin feels strongly that government spending should not significantly exceed its current rate of about 16.8 percent of GDP and overall government debt should slowly decline. The Finance Ministry has announced that public debt will not exceed 50 percent of GDP (currently around 48 percent) and the government debt/service ratio will stay below 15 percent of GDP. Thaksin views monetary and fiscal stability as prerequisites to business confidence and progress on these metrics as a sort of report card on how well his administration is proceeding on the economic front in general. Besides, he believes there is another, more effective, way to finance his ambitious plans.

¶14. (SBU) There is no shortage of capital in Thailand. Banks remain flush with more than Bt200 billion in unloaned funds even though real interest rates on deposits are negative and commercial bank lending rose 6.8 percent in 2004. The RTG is seeking to mobilize this capital to fund infrastructure and upgrade private sector capacity and efficiency. The buzzwords to accomplish this are "public-private partnerships" and, "Special Purpose Vehicles" (SPVs). An example being mooted of how this might work for an extension of the Bangkok subway system is the creation of an SPV to which the RTG would cede control on government-owned land under which the subway would be routed. The SPV would develop the property above ground and finance the digging of subway tunnels below. In return for the land, the RTG would own a minority share of the SPV. The SPV would issue bonds - not backed by an RTG guarantee -to finance the real estate development projects and subway construction with interest and principle repayments financed by the rent and eventual sale of the office and/or commercial sites developed and rent on the tunnels paid by the subway operator. A second SPV would run the subway with the purchase of rails and rolling stock financed by a second

issuance of non-guaranteed bonds to be repaid from subway fares and underground real estate development. A major purchaser of the bonds would probably be government pension and social security funds (the social security fund currently has Bt268 billion - US$6.7 billion, in assets). In one blow infrastructure is developed and Thai savings mobilized all at no change or risk to the government balance sheet. Should anything go wrong, however, and pensions put at risk from non-performing SPV bonds, the RTG would have a major problem. There is also the question of how much real estate would need to be developed to finance the subway and whether this supply-led building boom would negatively influence the Bangkok real estate market.

¶15. (SBU) In addition to the physical infrastructure to be developed, the government recognizes that for industry to be more competitive the intellectual and job skills of Thai workers must be enhanced. Thai schools are widely seen as poorly funded and teachers badly trained with most teaching by rote. The individual Thaksin names as new Education minister will indicate the seriousness of the new administration in tackling this matter. Thaksin is also keen to increase the amount Thai companies spend on research and development, currently only 0.13 percent of GDP (Malaysia-a country Thaksin views as a key competitor-spends at rate about five times greater).

¶16. (SBU) COMMENT. The Prime Minister has a clear vision for Thailand's economy and usually takes decisive actions towards its realization. The risk that he, and the country, run is that sometimes his decisions are not well thought-out and may result in short-term gains and long-term costs. An example; Thai commercial banks have become quite conservative lenders following their climb back from the 1997 crisis. Seeing a lack of lending to stimulate the economy, Thaksin ordered state-owned Krung Thai bank to be more aggressive in making loans. The bank did so, increasing its loan portfolio at a rate more than double that of its nearest competitor. Unfortunately, the quality of some of the larger loans was poor and Krung Thai has been forced to make major asset write-downs and some of its top executives are being indicted for corruption and malfeasance. Other quickly and poorly executed plans, such as the agreement with China for free trade in certain agricultural goods, was based more on vision without sufficient attention to details.

¶17. (SBU) We know the direction Thaksin wants to take the economy during his second term. We do not know if he has learned the need for better preparation and better guidance for the implementing bureaucrats. We also must wait and see if Thaksin's stated vision of a reformed business sector is something he is willing to aggressively fight for, e.g. taking on entrenched local elites who are likely to oppose a comprehensive FTA with the U.S. The structure of his new cabinet should be the first clue in answering these questions.
BOYCE